

LABOR MARKET REGULATION, JOB CREATION AND EMPLOYMENT ADJUSTMENT:

Evidence from international firm-level data

Reyes Aterido

and

Carmen Pagés

The World Bank

In this paper we make use of a unique firm-level dataset gathering information on a large number of variables for more than 20000 firms in 57 transition, emerging and low income economies worldwide to assess the impact of labor regulations on job creation and employment adjustment. To do so, we take advantage of two sources of variation in regulations. The first source comes from large cross-country differences in *de-jure* employment protection regulations. The second comes from individual firms' own perceptions on the stringency of labor regulations. We acknowledge that OLS estimation based on either source of variation is subjected to a number of potential omitted variable and endogeneity problems and address them by means of instrumental variable and difference-in-differences estimation.

We find that around the world, larger firms, firms that innovate, firms with more educated managers, firms that export to the world markets, and firms more than five years old, perceive labor regulations as more of an obstacle to their growth. We also find that the presence of unions in the workforce of a firm increases managers' perceived stringency of labor regulations. We apply a two-step procedure in which we make use of this variation across firms to instrument individual perceptions on the stringency of labor regulation. We find that labor regulations slow down employment adjustment to changes in value added and that these effects occur predominantly in large firms. We also analyze whether the effect of regulations in altering adjustment is asymmetric in times of expanding and contracting value added. Importantly, we also assess the effects of regulations on net job creation across different types of firms. Overall, we find our results based on instrumented individual perceptions to be similar to the ones obtained exploiting differences in objective measures of regulation.